

SECTION III

CURRENT ENVIRONMENT

INTRODUCTION TO THE CURRENT ENVIRONMENT

Purpose

The Current Environment section reports on the Department of Defense's (DoD's) progress in achieving its financial management goals and actions and offers an overview of the DoD's financial management structure. In addition to examining the present status of financial management, this section also identifies areas requiring improvement. Finally, this section identifies how the DoD will move from its present status to an integrated financial management system.

Scope

The DoD is in the process of bringing its critical finance, accounting, and feeder systems into compliance with applicable federal requirements. In this regard, the DoD tasked each DoD Component to evaluate how well its respective systems comply with those federal requirements.

The DoD also has developed several strategies designed to enable it to reach an integrated financial management system and achieve auditable financial statements. Ultimately, the DoD intends to achieve auditable financial statements by reforming and improving its financial management processes.

Achievements and Progress To Date

DoD Goals

The DoD's 1998 Plan identified three long-term financial management goals to help set priorities and measure programmatic success. These three goals are to:

- Implement effective systems
- Reengineer business practices
- Improve the financial management framework.

These goals seek to ensure that financial management better fulfills the needs of its leaders, meets statutory requirements, maximizes efficiency, minimizes opportunities for fraud, and provides outstanding customer service. The DoD is taking aggressive actions to achieve its three long-term financial management goals. The DoD's actions are discussed in detail in this section.

Implement Effective Systems

Implementing effective systems pertains to two segments of the integrated financial management system, i.e., critical finance and accounting systems and critical feeder systems. The DoD strategies to achieve this goal include:

- Ensuring that critical finance, accounting, and feeder systems comply with statutory, regulatory, and audit requirements
- Monitoring the compliance status of each critical finance, accounting, and feeder system through the Financial and Feeder Systems Compliance Process
- Eliminating unnecessary finance and accounting systems and consolidating remaining systems into a cohesive set
- Employing technology improvements to develop standard systems
- Implementing single source data entry
- Ensuring that systems provide accurate and timely data to internal and external stakeholders.

Reengineer Business Practices

Reengineering business practices incorporates the policy and oversight segment of the integrated financial management system. To reengineer its business practices, the DoD Components shall:

- Analyze, revise, and implement procedures to eliminate needless or duplicative actions
- Revise regulations and procedures to simplify, standardize, and improve financial management requirements
- Improve accountability by ensuring that management controls are integrated into day-to-day operations
- Maintain an oversight structure to ensure senior leaders are involved in the financial management reform process
- Provide policies and procedures that are clear and simple, and which ensure compliance with existing laws and regulations

- Strengthen the partnership with other federal agencies
- Strengthen the partnership between the financial and accounting systems management community and the feeder systems management community.

Improve Financial Management Framework

Improving the financial management framework incorporates the infrastructure segment of the integrated financial management system. To improve its financial management framework, the DoD Components shall:

- Employ logically integrated or interfaced databases with flexible infrastructure supporting future changes
- Use modern technology to develop flexible, streamlined processes and procedures
- Develop standard data elements within the DoD and coordinate with other federal agencies to facilitate government-wide standards
- Ensure a qualified and competent DoD workforce through financial management training
- Develop a mentoring program to include professional development and active communication channels
- Safeguard information and resources against fraud, waste, abuse, and mismanagement through adequate internal controls
- Monitor and report on progress in achieving the DoD's integrated financial management system.

Implementing Effective Systems

The DoD is making effective progress in achieving its goal of implementing effective systems. For FY 2000, the DoD identified 76 critical finance and accounting systems and intends to reduce substantially the number of those systems. In FY 1998, for the first time, the DoD identified critical feeder systems in its official inventory. This year, the DoD identified 91 feeder systems as critical. The DoD also identified 20 critical financial management systems that are under development. The DoD's inventory of critical finance, accounting, and feeder systems is located in Appendix B, and the list of financial management systems initiatives is located in Appendix C of this volume.

In March 1999, a memorandum from the Principal Deputy Under Secretary of Defense (Comptroller) directed owners of critical finance, accounting, and feeder systems to evaluate their systems for compliance by March 31, 2000. Where systems were noncompliant, deficiencies were to be identified and action plans for resolving those deficiencies created.

The memorandum also required that, after systems had been evaluated, the Defense Finance and Accounting Service (DFAS) and critical feeder systems owners jointly were to establish memorandums of agreement (MOAs).

These MOAs provide an overall coordination mechanism to correct deficiencies and internal control weaknesses, and underpin full integration of all critical finance, accounting, and feeder systems. The DoD intends to measure the results of its goal by overseeing and monitoring current or needed actions to ensure that its critical finance, accounting, and feeder systems meet federal financial management requirements. That process is explained in more detail in the Transition Plan section of this Plan.

U.S. Army The Army supports the DoD's goal of implementing effective systems. The Army reported 21 critical accounting and feeder systems for the FY 2000 systems inventory (Appendix B) and 2 financial management systems initiatives (Appendix C). The Army has reported 15 of its critical systems as legacy systems, 2 systems as compliant, and 4 systems as "not determined". The Army's Defense Travel System-Limited (DTS-L) and Obligation Adjustment Matrix infrastructure initiatives emphasize the Army's commitment to support the DoD's effort to implement effective systems.

The Army's DTS-L initiative is an automated process for preparing travel orders that uses static databases for airline flights and per diem tables (which will be updated monthly to help develop cost estimates). Travelers use DTS-L to prepare their own trip orders, travel profile, and itinerary planning. In addition, the DTS-L allows travel professionals and managers to estimate whether hotel costs fall within established per diem rates and allows payment options for travel vouchers. The Army's Obligation Adjustment Matrix grants DFAS and Army accounting activities the authority to post an obligation when there is an unrecorded or insufficient obligation. The authority to post an obligation is based on the existence of documentary evidence of the obligation. Effective July 1, 2000, the Obligation Adjustment Matrix became an Army-wide standard business practice. This initiative has significantly facilitated reduction of problem disbursements.

U.S. Navy and U.S. Marine Corps The Department of the Navy (DoN) supports the DoD's goal of implementing effective systems. The DoN reported 33 critical accounting and feeder systems for the FY 2000 systems inventory (Appendix B) and 1 financial management system initiative (Appendix C). The DoN reported 13 of its critical systems as legacy systems, 5 as compliant systems, and 15 as noncompliant systems. The following policy and oversight and infrastructure initiatives further emphasize the DoN's commitment to support the DoD's effort to implement effective systems.

The DoN has formed 13 nonfinancial feeder teams to identify, review for compliance, and select DoN-wide standard nonfinancial feeder systems for its functional areas. For example, the DoN has selected the Defense Property Accountability System (DPAS) for all DoN personal property. The DPAS implementation at all Marine Corps facilities has been completed. Implementation at Navy facilities is well underway.

Similarly, the Facility Inventory Planning System (FIPS) and the Standard Labor Data Collection and Distribution Application (SLDCADA) system respectively have been selected as the DoN standard real property and time and attendance systems. Implementation or corrective compliance actions currently are underway. In the area of operating materials and supplies, the DoN is reducing 41 command systems to 8 standard DoN-wide systems with further review and consolidation under consideration.

The DoN has converted its general appropriated fund accounting to the DFAS's Standard Accounting and Reporting System (STARS). The DoN is in the process of converting its working capital funded industrial and research activities to the DFAS's Defense Industrial Financial Management System (DIFMS). The DoN's working capital funded Public Works Centers are being converted to the DFAS's Defense Working Capital Fund Accounting System (DWAS). Additional review, implementation, and corrective actions are underway for these and other systems and functional areas.

U.S. Air Force The Air Force supports the DoD's goal of implementing effective systems. The Air Force reported 42 critical feeder systems for the FY 2000 systems inventory (Appendix B) and 4 financial management systems initiatives (Appendix C). The Air Force reported 25 of its critical systems as legacy systems, 11 systems as noncompliant, and 6 systems as "not determined". The Air Force's Global Combat Support System-Air Force (GCSS-AF) and Financial Information Systems Assessment Study policy and oversight initiatives emphasize the Air Force's commitment to supporting the DoD's effort to implement effective systems.

The GCSS-AF initiative integrates Air Force combat support information systems to provide timely, accurate, and trusted information to the warfighter and supporting elements. The GCSS-AF is the process by which the combat support automated information systems (AIS) transmits information to users and other AISs in both warfighting and functional communities to facilitate performance. The Air Force's Financial Information Systems Assessment Study initiated an assessment to (1) identify all functional and technical interactions among the financial systems that serve the Air Force and (2) provide a plan to remedy any significant deficiencies. The objective was to create an integrated, efficient set of systems that support Air Force business processes and financial reporting.

Defense Agencies/DoD Field Activities The Defense Agencies/DoD Field Activities support the DoD's goal of implementing effective systems. The Defense Agencies/DoD Field Activities reported 23 critical finance, accounting, and feeder systems for the FY 2000 systems inventory (Appendix B) and 4 financial management systems initiatives (Appendix C). The Defense Agencies/DoD Field Activities reported 13 of their critical systems as legacy systems, 4 as compliant systems, 2 as noncompliant systems, and 4 systems as "not determined".

DFAS	<p>The DFAS supports the DoD's goal of implementing effective systems. The DFAS reported 48 critical finance, accounting, and feeder systems for the FY 2000 systems inventory (Appendix B) and 9 financial management systems initiatives (Appendix C). The DFAS reported 33 of its critical systems as legacy systems, 8 as compliant systems, 6 as noncompliant systems, and 1 system as "not determined".</p> <p>To overcome the reality of numerous, incompatible, and noncompliant finance and accounting systems that it inherited from the Military Departments, the DFAS embarked on a major effort to streamline all financial systems in its systems inventory. As of September 2000, 48 finance, accounting, and feeder systems were operating. Finance systems have been reduced to 13, with a goal of dropping to just 9 by 2003. Accounting systems are down to 34, with a goal of 22 or fewer by 2003, and feeder systems are down to 1. By 2003, the DFAS expects to account for and pay over 2 million service members, 2.2 million retirees and annuitants, over 700,000 civilian employees, and 200,000 contractors using just 32 or fewer finance and accounting systems.</p> <p>These consolidations are achieving genuine benefits and savings. For example, in bringing into a single system the DoD's 700,000 civilian payroll accounts, 26 separate systems were eliminated and 348 payroll offices were closed. From a productivity perspective, a typical civilian payroll technician in 1999 handled over 2,100 accounts, compared with just 380 accounts in 1991.</p> <p>The objective of the DoD's initiative, however, is not simply to reduce the number of financial management systems and support staff. This consolidation enables the DoD to meet federal financial management systems requirements, adhere to new federal accounting standards, and use the United States Government Standard General Ledger (USGSQL) at the transaction level.</p>
Reengineering Business Processes	<p>The DoD's second goal--reengineer business practices--is a critical aspect of the DoD's financial management reform. The DoD's business practices are the procedures by which management and administrative systems function. The objective is to make the DoD's business practices simpler, more efficient, and less prone to error. The Military Departments and the DFAS support this goal through the implementation of the following initiatives.</p>
U.S. Army	<p>The Army supports the DoD's goal of reengineering business practices through implementation of policy and oversight and infrastructure initiatives, such as its Single Stock Fund and Army General and National Defense Working Group-CFO initiatives. The Single Stock Fund initiative is designed to reengineer inventory management functions and processes throughout the Army. The focus of the Single Stock Fund effort is to eliminate the Supply and Management-Army account, using instead only the "parent" Army Working Capital Fund.</p>

The Army General and National Defense Equipment Working Group-CFO is an Army led joint working group that includes key Army, DFAS, DLA, Office of the Inspector General, DoD (OIG, DoD), and General Accounting Office (GAO) representation. The working group's purpose is to ensure that Army logistical systems comply with federal standards and improve the accuracy of reporting in annual financial statements.

U.S Navy and
U.S. Marine
Corps

The DoN supports the DoD's goal of reengineering business practices through the implementation of the following policy and oversight and infrastructure initiatives. The DoN's 13 nonfinancial feeder teams were given a mandate to review current DoN business practices with the goal to streamline systems and processes and eliminate redundancies. Great strides have been made in this effort. For example, the DoN's heritage nonfinancial feeder team has helped the DoN define the Heritage Asset reporting requirements, artifact classifications, and system requirements. The DoN's Hazardous Liabilities nonfinancial feeder team is developing policies, procedures, and systems requirements to gather nuclear waste and training range clean-up cost estimates and to oversee those clean-up efforts. The DoN also is reengineering the way it tracks and manages property in the hands of contractors to provide for better accountability of the DoN's assets.

U.S. Air Force

The Air Force supports the DoD's goal of reengineering business practices and has implemented the Improve Compliance, the Statement of Budgetary Resources, and the Improve Cost Accounting policy and oversight initiatives to achieve this goal. The Air force is also supporting the DoD's paperless acquisition process, and the government purchase card program.

The Air Force's Improve Compliance initiative established controls designed to ensure full compliance with financial laws and regulations. The Air Force established a Web-based checklist of internal controls to assist field personnel, and plans to comply with the internal controls part of base-level inspections. The Statement of Budgetary Resources initiative improves the existence and accuracy of Air Force obligation records. The DFAS-Denver Center is working with the Air Force Audit Agency to trace transactions from the financial statements to their source, with the goal of obtaining a positive opinion on the FY 2000 audit of the Air Force Statement of Budgetary Resources. The Improve Cost Accounting initiative aided in the development of the Air Force Total Cost of Ownership information system to provide better and more timely costs of supporting weapons systems to commanders. The Air Force also supports the use of Activity-Based Costing/Management as an important analytical technique for relating costs to specific activities. The Air Force continues to develop Activity-Based Costing/Management as part of its decision-making process.

The Air Force's business reengineering efforts in support of the DoD's goal to achieve paperless acquisition led to the development of the Automated Business Services System (ABSS). The ABSS introduced the capability to generate electronic forms and funding documents, to automatically route documents for

internal and external coordination, to electronically sign documents, to automatically upload commitments, and to automatically upload the standard contracting system. In response to the government purchase card program, the Air Force reengineered its processes, creating the Automated Purchase Card System. This system reduces the administrative financial management burden by automating the financial process, creating payment vouchers, and using EFT payments.

DFAS

The DFAS supports the DoD's goal of reengineering business practices. As a result of a number of initiatives, to include public and private partnerships, improving disbursement accounting, and financial management policies, the DFAS has reduced significantly its personnel requirements and operational costs, thereby creating more efficient and economical operations while improving services provided to its customers. Between FY 1993 and FY 1999, the personnel levels that the DFAS inherited from the Military Departments or Defense Agencies decreased by 37 percent (from 31,000 personnel in FY 1993 to 19,500 personnel at the end of FY 1999). By FY 2003, the DoD projects that DFAS personnel levels will decrease by another 2,000 personnel, to 17,500. Thus, over the 10 years between FY 1993 and FY 2003, the DFAS will have achieved a 44 percent reduction in personnel.

In FY 2000 constant dollars, the DFAS cost of operations has decreased from approximately \$2.0 billion in FY 1995, to \$1.7 billion in FY 1999--a 15 percent reduction. These savings in operating costs have been achieved despite the assumption of additional missions. Admittedly, these savings are being offset, in part, by the need to invest in new systems and technology. When compared with the DoD's operations as a whole, however, the DFAS budget equates to approximately six-tenths of one percent of the DoD's budget. This is about one-half the private industry average of 1.2 percent for this function.

Public-Private Partnerships. The DFAS has successfully used competition within the government and with the private sector to improve support services and save money. The DoD recognizes that many finance and accounting functions can be competed without posing a significant risk to the DoD's operations. The DFAS has recognized that approximately 85 percent of its personnel perform functions that might be eligible for outsourcing on a competitive basis.

To date, approximately one-third of the DFAS operations, measured in terms of costs, either have been outsourced, competed for outsourcing, or are in the process of an outsourcing competition. In addition, the DFAS has committed to study over 6,000 positions during the next 5 years.

Changes implemented by the DFAS, as a result of competition studies, already have produced annual savings of \$36.9 million through the streamlining of administration operations, facilities, and logistics; vendor payments; transportation accounting; depot maintenance accounting; and by consolidating debt and claims management. Within the financial community, the DoD is using public-private

competition--the A-76 process--to improve functions in other areas, such as civilian and retiree/annuitant payroll and security assistance accounting.

Improving Disbursement Accounting. Nearly all of the DoD's payments are matched to recorded obligations at the time the payment is made or shortly thereafter. A small percentage of payments, however, require additional time and research to ensure the transactions are recorded correctly in the DoD's accounting records. This additional effort is required because, within the DoD, separate offices and separate automated systems often are used to record the obligation of purchases in the accounting records, compute payment entitlements (i.e., determine how much should be paid and when), disburse funds (i.e., make payments), and then record the payment in the accounting system.

This separation of duties reflects sound internal control techniques. Because the applicable entitlement, payment, and accounting systems are not fully integrated, however, some of the data required to process these transactions must be input manually into the DoD's automated systems. This creates the potential for "unmatched" transactions as the data flow between the various DoD systems. For example, simple keystroke errors may occur during the process of manually inputting the same data into different systems. Such errors can result in data not matching when comparable information subsequently is transmitted between systems.

Disbursement-matching problems have been reduced by over 80 percent in recent years. Although the DoD considers such problems a matter to be taken seriously, almost all such expenditures connected with these disbursements were in fact, made only after a DoD official confirmed the goods or services were received and the payment was in accordance with a valid contract.

Prevalidation, the procedure of matching a disbursement to an obligation before (rather than after) a payment is made, has helped to reduce significantly those accounting problems associated with disbursements. Thresholds for applying prevalidation gradually are being lowered and, ultimately, virtually all payments will be prevalidated. In addition to prevalidation, the DoD also is implementing the Defense Cash Accountability System (DCAS), through which disbursement voucher data is collected electronically under one central standard system and distributed electronically for posting to accounting systems. The DCAS is expected to reduce the DoD's accounting cycle for disbursements from over 90 days to approximately 48 hours.

Financial Management Policies. The DoD has replaced approximately 30,000 pages of separate, and sometimes conflicting, financial management regulations, policies, and procedures with a single standard Department of Defense Financial Management Regulation ("DoDFMR"). To ensure the widest possible distribution of the policies contained in the "DoDFMR," that regulation has been made available on the Internet and on CD-ROM.

In January 2000, the DoD began reviewing the approximately 40,000 remaining pages of financial management policy and procedures still in publication within the Military Departments and Defense Agencies as part of its initiative to abolish superfluous financial management guidance. Work continues on rewriting, eliminating, merging, and reformatting guidance for insertion into the main body of the “DoDFMR,” or as system-specific appendices.

Improving Financial Management

The DoD is achieving its third goal--improving its financial management framework--by incorporating the infrastructure initiatives that improve the environment in which financial management operates. Strengthening internal controls and developing electronic information exchange will lessen the risk that financial management might be subverted. In addition, efforts underway to improve the education and training of financial management personnel will help ensure that the DoD operates with a well-qualified and highly motivated workforce.

U.S. Army

The Army supports the DoD’s goal of improving its financial management framework through the implementation of various policy and oversight initiatives such as the Army Joint Reconciliation Program and the Army Operating Materials and Supplies Process Action Team. The Joint Reconciliation Program involves a three-phased approach with current obligations reviewed in each phase. The joint reviews combine the skills and expertise of managerial accountants, budget analysts, and program directors. Service contracting, logistics, legal, internal review personnel, together with the DFAS personnel, may be used to assist in the joint review process. The Operating Materials and Supplies Process Action Team is reviewing current Army financial reporting practices and policies to ensure that the Army meets CFO Act requirements. The Army’s Financial Operations Conferences are conducted annually to help ensure that Army financial information is available to all interested Army personnel. The FY 2000 Conference offered 22 workshops that were attended by approximately 360 personnel from the Army and the DFAS financial management community.

The Army’s Internal Review Program infrastructure initiative embraced a worldwide community of professionals who meet the changing needs of the Army through responsive, timely, and flexible internal audit and related advisory services to Army commanders. The Internal Review offices prepare and execute annual audit plans to ensure that audit resources are used in the most effective way possible, helping give Army commanders the resources they need to be responsible stewards of the Army’s resources.

U.S. Navy and U.S. Marine Corps

The DoN supports the DoD’s goal of improving its financial management framework through the implementation of various policy and oversight and infrastructure initiatives to improve its financial management framework. The DoN has created the DoN Civilian Financial Management Career Program

Improvement initiative to improve the capabilities of its financial management workforce.

The DoN is reinforcing its requirement to conduct wall-to-wall inventories of all real, personal, inventory, operating materials and supplies, and heritage asset property to ensure the full accountability over all DoN assets.

In the area of internal controls, the DoN's Management Control Program Improvement Initiative, led by the Office of the Assistant Secretary of the Navy, (Financial Management and Comptroller), seeks to improve the DoN's cost efficiency by identifying and reporting business risks. This approach allows the DoN management to assess the internal control system against an established standard and, thereby, to identify basic weaknesses in operating, financial reporting, and legal/regulatory compliance controls, and take the actions needed to strengthen them. The DoN also mandated that its 13 nonfinancial feeder teams review, develop, or strengthen policies, procedures, and internal controls to properly account for property, personnel records, and liabilities. New guidance is being written for each functional area.

U.S. Air Force The Air Force supports the DoD's goal of improving its financial management framework through the implementation of its DoD Implementation Strategies and Professional Qualifications policy and oversight initiatives. As part of its DoD Implementation Strategies initiative, the Air Force uses Integrated Process Teams (IPTs) to support the DoD's implementation strategies. The IPT process, consisting of 14 teams, is co-sponsored by the Assistant Secretary of the Air Force, Financial Management (SAF/FM) and the Deputy Chief of Staff, Installation and Logistics (AF/IL) and includes representatives from logistics, communications, acquisition, and other organizations. Initially the IPTs focused strictly on fixing the logistics systems and logistics data. The focus now covers inventory reporting, inventory valuation, real property, environmental liabilities, ammunition, national defense equipment, acquisition, and equipment.

The Air Force's Professional Qualifications initiative began as an effort to improve the professional qualifications of Air Force financial management personnel. In May 1999, Air Force senior financial management leadership issued guidelines for the professional development of its financial managers. These guidelines apply to all financial management staff members who are involved in policy decisions or who are responsible for enforcing financial laws and regulations. All financial management personnel are responsible for establishing an Individual Development Plan and pursuing related training toward accomplishing the plan.

DFAS The DFAS supports the DoD's goal of improving its financial management framework by implementing initiatives such as its electronic exchange of information and financial management training and professional development. To strengthen internal controls and elevate fraud awareness, the DFAS is imple-

menting additional checks, balances, and approval requirements for transactions. These internal controls decrease the DoD's susceptibility to fraud, waste, and abuse within its finance and accounting operations. In implementing adequate internal controls, the DFAS strives to incorporate appropriate levels of verification without requiring excessive resources or hampering the DoD's ability to complete its mission.

The DFAS and other DoD Components also continue to implement information assurance programs and fraud detection and protection measures. Some of the more significant internal control efforts include:

- Creating a centralized Fraud and Internal Review Office within the DFAS to better ensure that programs achieve intended results; laws and regulations are obeyed; resources are appropriate for a program's mission; data is reliable; and fraud is prevented
- Enacting a complete review of the DoD's vendor pay systems to determine who has access and at what levels, and ensuring that the necessary separation of duties exists
- Implementing an employee internal control responsibility training program
- Strengthening in-house reviews to detect alterations of receiving reports
- Enhancing fraud awareness and prevention training for vendor pay employees.

Electronic Exchange of Information. The DFAS is promoting the paperless exchange of financial information through a variety of other initiatives. One of the primary benefits of these initiatives is the elimination of manual processing of various documents and, thereby, significantly increasing the accuracy and timeliness of information. Another major benefit is a reduction in the cost of processing data. Some examples of these initiatives include:

- Electronic Document Management (EDM) and World Wide Web (WWW) applications. The EDM and WWW applications are enabling on-line, real-time access to documents needed to perform bill paying and accounting operations. Under this process, contracts, bills of lading, and payment vouchers can be stored in an electronic file and shared among DFAS activities. Another application eliminates the need to print reports by converting them into an electronic format for on-line analysis, reconciliation, and reporting. The DFAS also uses EDM technology to (1) enhance the control and management of documents needed for bill-paying operations, regardless of the document format and (2) feed those images to the DoD's pay systems.
- Electronic Funds Transfer (EFT). The DFAS uses EFT to reduce the cost and improve the accuracy and timeliness of disbursements. Over 90 percent of the

DoD's civilian and military employees have their pay directly deposited into their personal bank accounts. The direct deposit participation rate for travel payments is now over 90 percent. In 1999, EFT accounted for about 90 percent of the total contract dollars disbursed by the DoD.

- Electronic Data Interchange (EDI). The DFAS uses EDI to send remittance information directly to vendors and currently is processing EDI contracts and contract modifications into its finance and accounting systems. The DFAS also will implement a Web-based system that gives vendors an economical way to submit electronic invoices.

Financial Management Training and Professional Development. The DoD's financial management reform initiatives have focused on organizational structure, infrastructure, policies, processes, and systems. The DoD recognizes that sound financial management practices also demand well-trained and well-qualified personnel. While the DoD's current financial management workforce is well qualified and motivated, its future workforce must be even better qualified. Accordingly, the DoD seeks to better prepare the next generation of DoD financial management leaders.

To that end, an extensive workforce development program is underway within the DoD. An agreement with the U.S. Department of Agriculture's Graduate School is in place under which over 2,000 financial management personnel are receiving a new 5-day class in 32 locations during this calendar year.

These classes address financial management challenges that face the DoD. This training is intended to ensure that the DoD's personnel "know the rules" that affect the administration of the DoD's funds. The DoD intends to continue presenting these classes to over 2,000 DoD financial management personnel each year over the next 5 years.

The DoD's financial management senior leaders also are encouraging members of their financial management community to obtain appropriate professional certifications such as Certified Public Accountant, Certified Government Financial Manager, Certified Internal Auditor, Certified Cash Manager, Certified Defense Financial Manager and other appropriate certifications. In addition to demonstrating professional competency, such professional certifications often impose a continuing education or training requirement to ensure that once certified, the individual remains current with changes in financial management requirements and retains his or her proficiency.

In cooperation with the American Society of Military Comptrollers, the DoD has initiated a new Certified Defense Financial Manager (CDFM) Program specifically geared toward DoD financial management personnel. The DoD believes there is a benefit to having a Defense certification program because of the complexity of (1) the DoD budget and its appropriations, (2) the Defense

Planning, Programming, and Budgeting System, (3) the DoD's accounting procedures, and (4) related financial management policies and procedures.

Eligibility requirements for the CDFM include a minimum of three years of relevant Defense financial management experience, or two years of relevant Defense financial management experience with an Associate or higher degree. Similar to other certification programs, the CDFM is a test-based program. Additionally, once certification is obtained, personnel must continue their professional education to retain their certifications.

The pursuit of professional standards for the DoD's financial management workforce should help ensure that the DoD continues to produce high quality financial managers. It also should demonstrate the knowledge and capability of the DoD's financial managers in an objective and measurable manner that is visible to the DoD's leaders, the Congress, and the American public. In short, greater attention to professional training and development is good, not only for the DoD's financial management community, but also for the DoD as a whole. Employees outside of the DoD's financial management community also must receive, and are receiving, appropriate financial management training.

Senior leadership and management training courses, such as the Military Departments' War Colleges, the National War College, and the Industrial College of the Armed Forces, have incorporated financial management modules into their curricula. In addition, many of the DoD's courses for mid-level leaders and managers, such as the Command and General Staff Colleges and the Army Management Staff College, include financial management modules as well.

Furthermore, the Defense Acquisition Workforce Improvement Act mandates training and certification of all DoD employees who serve in acquisition workforce designated positions. The training required for certification in some acquisition subspecialties includes elements of budget formulation, justification, and execution; accounting and auditing principles; internal controls; and other financial management principals.

Additionally, the DoD is developing training for its property managers and logisticians. This training not only will reinforce accountability requirements, but also will emphasize financial management principles. The training will show property managers and logisticians how their management responsibilities impact the DoD's efforts accurately to record and report property acquisition costs, acquisition and disposal dates, and depreciation. Property accountability modules within these training courses are intended to inform property managers and logisticians of the mandatory requirements for conducting physical inventories, the documentation requirements for such inventories, and the actions necessary to correct property accountability records and systems to reflect the results of physical inventories.

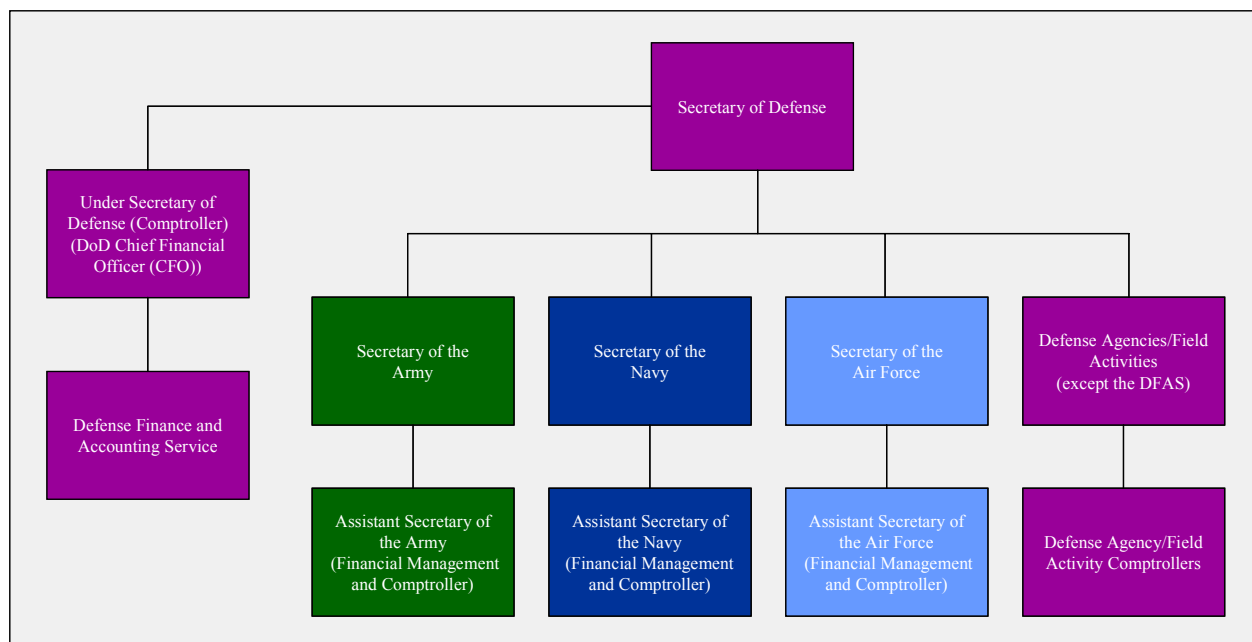
Roles and Responsibilities

Purpose

Over the past several years, the DoD's finance and accounting organizations and management structure have undergone major changes. Prior to the establishment of the DFAS, the Military Departments and the Defense Agencies were responsible for their own finance and accounting operations. Significantly, the DFAS now shares the finance and accounting responsibilities that previously belonged only to the Military Departments and the Defense Agencies.

Organization and Management

As illustrated in the figure below, two chains of command within the DoD perform finance and accounting operations. On one side is the DFAS, which reports to the Under Secretary of Defense (Comptroller) (USD(C)) within the Office of the Secretary of Defense. On the other side are the Military Departments, led by their respective Secretary, and the Defense Agencies, led by their respective Director. Each Military Department Secretary has an Assistant Secretary (Financial Management and Comptroller) who directs and manages financial management activities consistent with policies prescribed by the USD(C) and the Military Department's implementing directives. Each Defense Agency has a Comptroller who has similar responsibilities to the Defense Agencies.



Relationship between the Secretary of Defense and the DoD Components

Under Secretary of Defense (Comptroller)

The USD(C) is the principal advisor and assistant to the Secretary and Deputy Secretary of Defense for budgetary and fiscal matters (including financial management, accounting policy and systems, budget formulation and execution, and contract audit administration and organization), DoD program analysis and evaluation, and general management improvement programs.

The National Defense Authorization Act for Fiscal Year 1994 designated the USD(C) as the DoD's CFO. Specific duties include:

- Interpreting, augmenting and promulgating financial management laws, regulations, and guidance within the DoD
- Directing, managing, and providing policy guidance and oversight of agency financial management personnel, activities, and operations
- Developing and maintaining integrated financial and accounting management systems
- Monitoring the financial execution of the agency budgets in relation to actual expenditures, and preparing and submitting timely performance reports
- Overseeing the recruitment, selection, and training of personnel to carry out agency financial management functions.

The USD(C) has no direct line of authority over any of the financial management staffs within the Military Departments, the Defense Agencies (except the DFAS), or the DoD Field Activities. They report through their own organizational structure to their respective unit heads. The USD(C), however, does issue instructions, regulations, policies, and procedures relating to financial management matters and the production of financial statements, which are binding on all of the DoD Components.

Financial management functions are divided among the Military Departments, the Defense Agencies, the DoD Field Activities, and the DFAS. This division results in certain primary-level, programmatic financial functions remaining with the DoD Components.

Military Department

Each Military Department has an Assistant Secretary (Financial Management and Comptroller) who reports to the Military Department's Secretary and directs and manages financial management activities consistent with policies prescribed by the DoD CFO and the Military Department's implementing directives. The Assistant Secretary (Financial Management and Comptroller) position in each Military Department was established in the National Defense Authorization Act for FY 1989. This Act delineated many of the responsibilities of the office, including:

- Managing financial management activities and operations
- Directing the preparation of budget estimates
- Approving any asset management systems, including cash and credit management
- Collecting debts
- Accounting for property and inventory.

Defense Agencies/DoD Field Activities

Each Defense Agency/DoD Field Activity has a comptroller or senior financial manager who directs and manages financial management activities consistent with policies prescribed by the DoD CFO.

DFAS The DFAS is responsible for identifying and implementing finance and accounting requirements, systems, and functions for appropriated and non-appropriated funds, as well as working capital funds, revolving funds, and trust fund activities, including security assistance.

In December 1991, the DFAS assumed responsibility for all finance and accounting operations and the associated 332-installation finance and accounting offices and began to consolidate them. Today, the DFAS consists of a Headquarters located in Arlington, Virginia, with five centers located in Cleveland, Ohio; Columbus, Ohio; Denver, Colorado; Indianapolis, Indiana; and Kansas City, Missouri; and 19 operating locations (OPLOCs).

**DoD
Management
Oversight
Structure**

The DoD is using a senior management oversight structure to ensure that its senior leaders remain engaged in the financial improvement process. This structure includes the DoD Financial Management Steering Committee (FMSC) and the Working Capital Funds Policy Board (Policy Board), which are engaged actively in approving and monitoring the DoD's financial management reform efforts.

The DoD FMSC oversees the development of the functional requirements for general fund financial and accounting systems, facilitates the implementation of policy recommendations, and addresses financial management systems and practices. The Committee is chaired by the USD(C) and includes:

- The Principal Deputy Under Secretary of Defense (Comptroller)
- The DFAS Director
- Assistant Secretaries (Financial Management and Comptroller) of the three Military Departments
- The DoD Deputy Chief Financial Officer
- The Comptroller of the Defense Logistics Agency
- A senior official from the Office of the Assistant Secretary of Defense (Command, Control, Communications, and Information) (ASD (C3I)).

The Policy Board, which monitors the implementation and operation of the working capital funds, including policies, rates, cash flow analysis, and the criteria for inclusion of business areas therein, is chaired by the USD(C) and includes the Assistant Secretaries (Financial Management and Comptroller) of the three Military Departments and:

- The USD (Personnel & Readiness)
- The ASD (C3I)
- The DFAS Director
- Representatives from the Joint Chiefs of Staff
- The IG, DoD (serves as a special observer to the Policy Board).

Overarching policies, procedures, and reporting guidance for working capital fund activities were formally incorporated into the “DoDFMR” and published in December 1994. Three subcommittees, Oversight of Policy Actions, Cost Reductions, and Performance Review were established to develop recommendations and to review recommendations submitted to the Policy Board.

Military
Departments’
Financial
Management
Reform
Support

The Military Departments support the DoD Management Oversight Structure efforts by fielding various working groups, process action teams, integrated process teams, and nonfinancial feeder teams. The following initiatives demonstrate the Military Department’s financial management reform support.

The Army General and Mission Equipment Working Group – CFO Compliance Group is a joint working group that includes key Army and DFAS representation. This group works to ensure successful and accurate reporting of general and mission equipment in the Army. It determines key elements, possible approaches, and solutions for meeting existing and future reporting requirements for Army equipment, as well as changes in systems to meet equipment reporting requirements.

The Army’s Operating Materials and Supplies Process Action Team (OM&S PAT) was formed to review current Army financial reporting practices and policies for Operating Materials and Supplies and to make changes where appropriate to meet CFO Act requirements. The OM&S PAT members include key Army and Defense logistics and finance personnel, the DFAS, and audit community representation.

The Army’s Real Property Integrated Process Team (RP-IPT)-CFO Compliance Group is a joint working group that includes key Army and DFAS representation to help ensure the successful and accurate reporting of land, buildings, and structures. The RP-IPT determines approaches and solutions for meeting existing and future reporting requirements for the Army’s real property. The team currently is determining and implementing changes to existing systems to meet the reporting requirements for real property.

The DoN’s 13 Nonfinancial Feeder Teams were created to make its systems and processes comply with federal financial management systems requirements and to support the DoD Implementation Strategies initiatives. Political appointees, senior flag officers, or senior executives head each nonfinancial feeder team. Other members of these teams include functional representatives from the logistics, engineering, financial, and audit communities and representatives from each applicable management command. Representatives from the Deputy Under Secretary of the Navy’s Organization, Management and Infrastructure Team, and the ASN FM&C’s Office of Financial Operations coordinate these efforts.

The Air Force uses Integrated Process Teams to ensure its processes and systems comply with federal financial management requirements. The IPT process,

consisting of 14 teams, is cosponsored by the Assistant Secretary of the Air Force, Financial Management (SAF/FM) and the Deputy Chief of Staff, Installations and Logistics (AF/IL) and includes representatives from logistics, communications, acquisition, and other organizations. Initially the IPTs focused on strictly fixing the logistics systems and logistical data. The focus now covers inventory reporting, inventory valuation, real property, environmental liabilities, ammunition, national defense equipment, acquisition, and equipment.

Financial Management Structure

Operational Structure

The DoD's current financial management structure is divided among the Military Departments, the Defense Agencies, and the DoD Field Activities, and the DoD's primary financial accounting organization--the DFAS. The primary or source-level financial management data originate with the Military Department's and the Defense Agencies. These data then are fed to the DFAS where the data are processed in the DoD's finance and accounting systems.

As the DoD's primary financial management service organization, the DFAS processes transactions and prepares financial statements and reports. The DFAS charges user-based fees to the other DoD Components to cover the cost of those services.

The other DoD Components are responsible for providing the DFAS with source finance and accounting data. Operational commanders and program managers who acquire, manage, allocate, transport, use, or dispose of DoD resources generate these source data, called financial events. The Components own and operate the feeder systems that send data to the DFAS. The DFAS then processes these data and provides commanders and managers, at all levels, the financial information needed to make financial decisions, meet reporting requirements, and maintain the general ledger.

Finance Functions

The DFAS is organized to perform the DoD's basic finance operations. Finance operations include processing payments to DoD personnel, retirees, annuitants, and contractors. Currently, the DFAS performs the following seven finance activities, primarily focusing upon payment operations.

- Civilian Pay is the payment of DoD civilian employees
- Debt Management is the collection of debts from individuals and contractors
- Military, Retiree, and Annuitant Pay is the payment of uniformed personnel, military retirees, and dependents
- Contractor/Vendor Pay is the payment of commercial invoices
- Disbursing is the releasing of monies for various types of functions
- Transportation Payment is the payment for government bills of lading and transportation requests
- Travel Payment is the payment for official duty travel.

Accounting Functions

The DFAS also performs the DoD's basic accounting operations. Accounting operations include recording, reporting, and analyzing financial activity. Accounting functions currently consist of six activities.

- Working Capital Fund activities operate in a business-like environment where the customer requiring support pays for services or products on a unit-cost basis

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- General Fund supports the management of funds appropriated by the Congress to perform the DoD's missions
 - Security Assistance provides accounting support to activities that sell military equipment, weapons, technology, and training to foreign governments based on agreements with the United States
 - Departmental Reporting consolidates financial information from the Defense Working Capital Fund and General Fund accounting systems to produce fiduciary and managerial reports for the U.S. Treasury, the DoD, the Office of Management and Budget (OMB), the Military Departments, the Defense Agencies, the DoD Field Activities, and other federal agencies
 - Cash Accountability records, manages, and reports DoD expenditures to the U.S. Treasury. Accounting, pay, and disbursing systems update cash accountability information
 - Other Accounting Functions support the overall accounting process.
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DoD Components

With the establishment of the DFAS as the DoD's financial service organization, the other DoD Components generally no longer perform finance (disbursing) and accounting (general ledger) functions at the installation and Agency or Field Activity levels. However, those Components did retain managerial responsibilities to provide oversight, validation, and review of the following functions to support the activity commanders, Agency or Field Activity directors, and the DFAS OPLOCs:

- Reviewing and computing travel claims prior to forwarding them to the OPLOCs
 - Providing data electronically and forwarding documents to the OPLOCs
 - Assisting the OPLOCs with follow-up on problem transactions
 - Preparing and processing collection vouchers for checks and cash received locally
 - Distributing funds
 - Reconciling funding document differences
 - Inputting civilian and military pay transactions
 - Printing hard copy reports as required
 - Processing receiving reports
 - Interpreting accounting reports for the installation
 - Providing military pay customer service
 - Providing cash support for contingency operations
 - Monitoring legal limitations
 - Inputting accounting transactions (i.e., commitments, earnings, funds, inventory transfers, real property transfers, and obligations).
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**Technical
Supporting
Structure**

The DFAS maintains the principal systems required to perform finance and accounting functions. Each of the five DFAS Centers is responsible for supporting certain functions and the systems required to support those functions. Multiple systems are used to perform the majority of finance and accounting functions, although some functions are performed from one system. For example, the vendor pay function is performed at multiple DFAS locations using multiple Component-specific systems, while the DFAS-Cleveland Center performs the retired pay function and uses one system to support this function.

The DoD Components maintain feeder systems to support their respective missions, although not all feeder systems contain source-level financial management information. Feeder systems that contain information necessary for financial management are considered critical feeder data systems. These critical feeder systems send finance and accounting information to DFAS systems through real-time, electronic, or manual interfaces.

The DoD currently is employing technological improvements, which include the use, where appropriate, of electronic commerce/electronic data interchange (EC/EDI). In addition, the DFAS has implemented a Web invoicing system that enables a vendor to enter invoices into templates on a DFAS web server that processes and routes the invoices to the appropriate payment system. The vendors gain all the benefits of submitting their invoices electronically, but eliminate high costs associated with EDI. The benefit of using these electronic processes include one-time data entry, which decreases the opportunity for data error. The benefit of EC is that it enables prompt processing of vendor invoicing and reduces the amount of paper used. Organizations throughout the DoD are in different stages of implementing EC/EDI.

The DoD also is using EFT. Currently, over 90 percent of DoD civilian employees and military personnel have their pay directly deposited into their accounts through EFT. The DFAS also is implementing EFT in its vendor pay systems. Vendors can receive payment of funds electronically by registering their financial institution account information through the DoD's Central Contractor Registration (CCR), which is accessible on-line from a CCR website.

Financial Management Status

Scope

The DoD's financial management is a "work-in-progress" designed to fulfill the needs of its leaders, meet statutory and regulatory requirements, maximize operational efficiency, and minimize fraud. There have been notable successes, but progress is slow in some areas. It is impossible to reverse decades-old problems overnight, and some reforms will require several years to implement.

This section reports on the progress that the DoD has made toward developing effective financial management that will result in auditable financial statements. It discusses the progress toward achieving the long-term solution of an integrated financial management system that was identified in the Concept and includes a review of impediments to auditable financial statements and actions being taken to remove those impediments.

The current status of the DoD's financial management is discussed in five areas:

- Critical finance and accounting systems
 - Critical feeder systems
 - Policy and oversight
 - Infrastructure
 - Implementation strategies.
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Critical Finance and Accounting Systems

Automated finance and accounting systems are the foundation--the essential tools--of the financial management process. They provide the "raw material" for fiduciary accounting, financial analysis, and decision-making. The DoD identified 76 critical systems as its 2000 baseline of finance and accounting systems and 12 critical financial management systems initiatives.

The DoD has evaluated these systems for compliance with federal financial management systems requirements and accounting standards. Of the DoD's 76 critical finance and accounting systems, 13 systems are reported as compliant, 11 systems are reported as noncompliant, and the status of 1 systems has not been determined. There are 51-legacy finance and accounting systems reported as scheduled either for elimination or replacement.

Critical Feeder Systems

Achieving reliable financial management reports requires enormous efforts from all functional communities within the DoD, not just the financial management community. Much of the data needed for sound financial management comes from systems operated by those functional communities other than the financial management community. These feeder systems (supporting functions such as acquisition, personnel, cost management, property, and inventory) are owned by

their respective functional communities. Therefore, much of the effort involves working with those communities in order to upgrade their systems to improve data integrity, internal controls, and interfaces with the DoD's financial management systems.

In 2000, the DoD identified 91 critical feeder systems and 8 critical financial management systems initiatives. The DoD Components have been evaluating and continue to evaluate their critical systems for compliance with federal financial management systems requirements and accounting standards. Of the 91 critical feeder systems, 6 systems are reported as compliant, 23 systems are reported as noncompliant, and the status of 14 systems has not been determined. There are 48 legacy critical feeder systems reported as scheduled either for elimination or replacement.

Policy and Oversight

In recent years, the DoD has promulgated more stringent financial management guidance both for the financial management community and other supported communities. Such policies address, but are not limited to:

- Fully and accurately reporting general and mission equipment
- Reviewing effective budget execution and obligations
- Reviewing financial reporting practices and policies
- Fully and accurately reporting land, buildings, and structures
- Providing strategies and goals to comptrollers for development of their financial workforce
- Providing an approach to identify and report business risks
- Reviewing policies and procedures related to expected hazardous waste removal and disposal costs for ammunition and chemical weapons
- Improving the reporting of deferred maintenance
- Improving the reporting of government-furnished property in the hands of contractors
- Resolving policy and guidance issues, accounting issues, systems issues, and implementation strategies to produce auditable financial statements
- Identifying functional and technical interactions among financial systems and providing a plan to remedy any significant deficiencies
- Compliance with financial laws and regulations
- Reporting better and timelier weapon system costs
- Improving professional qualifications of financial management personnel
- Establishing a comprehensive career development program for financial management positions
- Funding employee pursuit of educational advancement, leader development, technical competency development, and professional certification
- Developing a single financial management regulation for use by the DoD.

The DoD also has strengthened its managerial internal controls by implementing new checks, balances, and approval requirements for transactions that affect resources. Internal controls decrease the DoD's susceptibility to fraud, waste, abuse, and mismanagement within its financial management operations. The DoD strives to incorporate the appropriate levels of verification without requiring excessive resources or hampering the ability to complete the mission. Over the past 12 months, the DoD has taken significant steps to improve internal controls to include:

- Effecting a complete review of the DoD's vendor pay systems to determine who has access and at what levels, ensuring the necessary separation of duties
- Strengthening in-house reviews to detect improper alterations of receiving reports
- Enhancing fraud awareness and prevention training for vendor pay employees.

Infrastructure A supporting infrastructure is essential in order to achieve the objective of an integrated financial management system. The infrastructure provides an environment in which efficient and effective financial management operations may be conducted. The DoD's infrastructure initiatives include:

- Preparing travel orders and using static databases for airline flights and per diem tables
- Making financial information available to all interested personnel
- Providing responsive, timely, and flexible internal audit and related advisory services
- Posting an obligation when there is an unrecorded or insufficient obligation
- Reengineering inventory management functions and financial processes
- Determining whether systems can be cost effectively modified to provide information requirements
- Consolidating accountability and financial accounting and reporting purposes
- Examining the feasibility of creating a summary-level database to serve as a central information repository for financial statements
- Reviewing current guidance, directives, business processes, and information systems to ensure full accountability and visibility
- Examining the existing inventory management systems to define approaches and solutions to meet federal requirements for financial management
- Considering opportunities for standardization and consolidation of similar actions
- Examining the current processing of source data automation from active and reserve personnel management systems to determine areas that require modification to comply with financial management system requirements

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- Evaluating time and attendance systems to determine the practicality of usage
 - Providing the capability to capture actual and planned direct labor and direct material at the task level and report on a daily basis
 - Integrating combat support information systems to provide timely, accurate, and trustworthy information
 - Providing an approach to implementing a goal and strategy for protection and security of commercial and defense critical infrastructures
 - Providing a single, shared data environment for financial systems
 - Improving the FMFIA Section 2 program by implementing needed improvements to the existing internal review program
 - Meeting the challenges of rapidly advancing technology and providing a fraud detection and prevention unit
 - Monitoring the development and deployment of automated systems to ensure that the proper internal review controls have been incorporated into automated systems
 - Developing a strategy to pursue a system's integration strategy to achieve FFMIA-compliant finance and accounting systems.
 - Providing a single fully integrated military personnel and pay system.
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**Implementa-
tion
Strategies**

While significantly enhancing systems is the overall long-term solution for addressing the DoD's financial management deficiencies, there is much that the DoD can, and is doing now. In parallel, the DoD has developed interim methods that will help it achieve more acceptable results and will support achieving favorable audit opinions on its financial statements.

Major "non-system" deficiencies that contributed to the DoD not receiving favorable audit opinions on its financial statements in the past have been identified. Alternative methods to deal with these deficiencies have been developed and coordinated with the OMB, the GAO, and the OIG, DoD.

The DoD has developed short-term strategies to address the deficiencies and identified responsible parties and milestone dates. To help ensure that the DoD stays on track, applicable DoD organizations report on their progress and, as appropriate, update their plans.

The strategies focus on correcting deficiencies in the following areas:

- Inventory
- Operating materials and supplies (OM&S)
- Property, plant, and equipment (PP&E)
- Future liabilities
- Fund balances with the U.S. Treasury
- Intra-governmental eliminations.

Inventory The inventory challenges facing the DoD include verifying existence, completeness, and proper valuation of inventory. An important part of the DoD's financial management operations is the ability consistently to value and reconcile inventory data to financial account balances. Current accounting standards require the DoD to report inventory at historical cost or at latest acquisition cost adjusted by an allowance for unrealized gains and losses to approximate historical cost. Unfortunately, the DoD's present inventory systems cannot support either costing method. Instead, to approximate historical costs inventory managers must calculate the DoD's inventory assets value at standard (selling) prices. Inventory values are not included in the DoD's financial systems, but in logistical inventory systems. Consequently, the dollar value of inventory reported on financial statements is a calculated amount, not a system-driven amount. These calculated amounts are determined using a computational formula that adjusts inventory values to an approximation of historical cost and latest acquisition cost.

To improve the reliability of inventory amounts reported in its financial statements, the DoD is taking actions to:

- Identify systemic errors in inventory transaction processing (issues and receipts) and the need for routine manual adjustments, determine the sources and causes of those errors and adjustments, and develop a remediation plan to correct such errors and eliminate the need for adjustments.
- Improve controls over physical inventories by establishing physical inventory plans and procedures for statistical sampling and cycle counts, ensure personnel who perform physical inventory counts do not have physical control over inventory, implement risk and sensitivity-based count and control procedures, and promptly reconcile physical and financial records.
- Use independent personnel to ensure accounting adjustments are recorded in compliance with regulations and established business practices.
- Improve controls over intransit inventory to ensure that receipts and issues are properly and promptly posted to appropriate records.
- Improve the accuracy of the valuation of inventory by approximating the historical cost for the beginning inventory balance, continue to use formulas to approximate historical cost where inventory is controlled through systems that do not report historical cost, and work toward a consensus on the accounting treatment of inventory gain and loss accounts, the valuation of reparable items, and revenue from sales of reparable items.

OM&S Currently, OM&S is a significant component of the DoD's total financial responsibility. It is important that the DoD clearly define and accurately value the different categories of OM&S. OM&S involve two material issues:

- Definition of what constitutes OM&S
- Valuation (consumption method of accounting).

The DoD is developing detailed descriptions of the different classifications of OM&S (e.g., definition of OM&S and categories of OM&S) for release to the DoD Components.

For specific categories of OM&S, the DoD prefers to use the consumption method of accounting. Under the consumption method, an asset is considered consumed when the asset is issued to the user (e.g., a tank, ship, or plane). This method would apply to OM&S categories that are expensed when used, for example, munitions. The DoD asserts that for specific OM&S assets, the consumption method of accounting has distinct advantages. The DoD will develop a method for applying the consumption method. Cost-benefit analyses will be conducted to determine when the use of the consumption method is cost-effective.

PP&E

The DoD faces several challenges involving accounting for and reporting of PP&E. These include the following:

- Existence and completeness
- Valuation
- Government property in possession of contractors
- Deferred maintenance.

The accounting standard for the recording of General PP&E requires that (1) it be recorded at historical cost and depreciated, (2) costs incurred to bring the assets into fully operational conditions be included in the recorded cost, and (3) estimates are to be used when the historical cost of existing general PP&E assets is not available. The DoD's property accountability systems were not designed to capture, retain, and depreciate the costs of PP&E assets.

Under the DoD's implementation strategy, unless a DoD Component has a fully operational property accountability system that meets applicable requirements (to include the capability to capture and maintain historical cost data and calculate depreciation), it must expedite the implementation of a CFO compliant property system for its General PP&E assets prior to the end of FY 2003.

Beginning in FY 1999, newly acquired General PP&E assets are capitalized at acquisition cost, and the supporting documentation retained in accordance with appropriate regulations. For General PP&E assets acquired prior to FY 1999, the DoD is working with its auditors and has hired private accounting firms to develop an acceptable method for a valuing General PP&E where adequate documentation does not exist.

As of September 30, 1999, the DoD had approximately \$70 billion in government-furnished property and material in the possession of contractors. The Federal Acquisition Regulation (FAR) requires contractors to maintain records for all government-furnished property in their possession and property they acquired on behalf of the DoD. The contractors annually report government-furnished property and material information to the DoD.

The FAR precludes federal agencies from keeping duplicate records; therefore, the DoD historically has relied on the contractors to provide financial information on government-funded assets. The DoD has determined that the only information it should need from DoD contractors, for annual financial statement purposes, is information pertaining to General PP&E personal property and improvements to real property.

The cost of deferred maintenance for PP&E must be reported as Required Supplemental Information to the annual financial statements. The DoD does not have automated systems to capture and report deferred maintenance estimates that can be tied back to specific PP&E assets, such as aircraft, tanks, or ships. In FY 1999, the DoD began reporting the deferred maintenance amounts reported by the DoD Components that are developed as part of the DoD's budget process for both general PP&E real property and National Defense PP&E assets. Both the FASAB and the OMB recognize that additional guidance needs to be developed for consistent and adequate government-wide disclosure of deferred maintenance amounts. The DoD is leading a government-wide task force to develop additional guidance and standard definitions, methodologies for determining maintenance requirements, and reporting guidelines.

Future Liabilities

The DoD also faces significant challenges regarding the estimated amount of its future liabilities as some future liabilities may not yet have been accurately assessed and reported. These include:

- Hazardous waste liabilities
- Disposal liabilities
- Post-retirement health care liabilities.

The DoD has established policies and procedures to address and estimate the expected disposal costs for major weapons systems such as aircraft, missiles, ships, submarines, and ammunition. The "DoDFMR" has been revised to incorporate specific guidance that identifies the requirement for managers, at all levels, to recognize future liabilities, including environmental cleanup and disposal costs. In reporting the actuarial liability for military post-retirement health benefits and claims, the DoD historically based these claims on funds that were obligated. The DoD is revising its procedures to better ensure that all data used in calculating the Military Retirement Health Benefits Liability is current and complete and that accurate, reliable, and complete data required to estimate post-retirement health care liabilities are captured and reported.

U.S. Treasury The DoD's appropriation balances on the books of the U.S. Treasury must
Fund Balances reconcile with appropriation balances on the DoD's books.

For all appropriations, the DFAS electronically transmits monthly collection and disbursement data to the Department of the Treasury. In addition, other agencies that collect and disburse funds for the DoD also report those amounts to the Department of the Treasury. The Treasury Department provides the DoD Components monthly and annual reports that show the fund balance reported by the Treasury. In the past, the DoD Components reported on their financial statements, the amounts from the Treasury Department instead of the balance reflected in the DoD's financial records.

Frequently, the account balances reported by the U.S. Treasury do not agree with the related account balances on the DoD's financial records. These differences are caused primarily by three items (1) separate accounting and reporting systems, (2) errors in the preparation of financial information and the perpetuation of those errors, and (3) the DoD collection and payment processes. The DoD has discontinued using the balances reported by the Treasury Department. Instead, it now reports the fund balances shown in the DoD's "Fund Balance With Treasury" general ledger accounts at the appropriation level, adjusted for valid changes.

Any differences between the amounts reported by the DoD and the balances in the corresponding U.S. Treasury accounts will be explained in footnotes to the DoD financial statements. (Normally, such differences are the result of intransit disbursements, collections, and funding adjustments reported to the U.S. Treasury DoD by other agencies but not yet reported to the DFAS Centers.)

Fund balances on the financial records of the DoD's installations must reconcile with related summary balances on the financial records of the headquarters. Fund balances for appropriations and changes thereto, along with the corresponding U.S. Treasury accounts, are maintained in the financial records of installations and headquarters. Monthly reconciliations between the installation-maintained accounts and the headquarters-level accounts should be performed. When performed, the installation fund balances may not agree with the account balances at the headquarters level. The result is a balance on the monthly financial statements that is not supported by the detailed financial records. The imbalances primarily are caused by three reasons (1) the variety of non-integrated databases in use preclude the easy and reliable integration or interfacing of information from other financial systems (2) the process of transferring documents among the various activities creates problems such as timing differences in posting transactions to the DoD financial records, as well as misplaced documents and (3) errors in the preparation of financial information and the perpetuation of those errors.

The DoD has directed its disbursing officers to comply with existing policy guidance and prepare a monthly transaction-level reconciliation between disbursement and collection activity reported to the Treasury Department, via the DFAS Centers. The DoD has directed each disbursing station to institute controls over the reconciliation process.

To improve this process in the long-term, the DoD plans to better integrate disbursing and accounting systems and require periodic reconciliations of the installation-level and headquarters-level funds with the U.S. Treasury account balances. The gradual lowering of the prevalidation limit reduced the level of differences in balances between DoD headquarters and the installations. Continual lowering of the prevalidation limit and its expansion to all disbursing stations will enhance its effectiveness.

Intra-
governmental
Eliminations

The DoD faces impediments to providing auditable financial statements because of problems with intra-governmental eliminations. Federal agencies may be required to verify the reported reconciliation of elimination amounts between agencies. Currently, there is no government-wide guidance concerning how to do this or effective tools to accomplish this requirement.

For financial statement purposes, the DoD is required to eliminate the financial effects of all intra-DoD transactions. Also, the DoD needs to provide data on all of its “intragovernmental” transactions with other federal agencies so that proper eliminations can be made on the government-wide financial statements.

The DoD’s strategy to improve intra-governmental eliminations includes a requirement that the DoD Components identify major trading partners that make up the bulk of interagency transaction balances. As part of the DoD’s long-term efforts to improve financial processes and systems, it will continue to identify both the buying and selling parties of each intra-governmental transaction at the transaction level and use this information to generate eliminating entries and/or conduct required reconciliations.

Remediation Plan Analysis

Background The FFMIA of 1996 requires each federal agency to implement and to maintain financial management systems that comply with federal financial management systems requirements, applicable federal accounting standards, and the USGSGl at the transaction level. The FFMIA requires that the head of each federal agency determine whether the financial management systems of that agency comply with the requirements discussed above. Such determination shall be based on a review of the report on the agency-wide audited financial statement, and any other information the head of the agency considers relevant and appropriate.

If the head of the agency determines that the agency's financial management systems do not comply with the requirements of the FFMIA, he or she, in consultation with the OMB Director, shall establish a remediation plan. This plan shall include resources, remedies, and intermediate target dates necessary to bring the agency's financial management systems into compliance.

Discussion The DoD has determined that, overall, its financial management systems do not comply with the FFMIA's mandated requirements. To bring its financial management systems into compliance, the DoD is using the resources, remedies, and intermediate target dates described in this Plan.

The DoD is committed to bringing its financial management systems into compliance with the requirements of the FFMIA and, as such, is implementing a long-term strategy. Volume II of this Plan details the corrective actions, milestones, and resources necessary to achieve compliance for the critical finance, accounting, and feeder systems.

The objectives under the DoD's strategy are to:

- Comply with statutory, regulatory, and audit requirements
- Eliminate unnecessary systems and consolidate finance and accounting functions to a select set of systems
- Employ improvements in technology to develop standard systems that use logically integrated or interfaced databases with flexible infrastructure supporting future changes
- Implement a "single entry" structure.

Intermediate Target Dates The major intermediate target dates toward achieving financial management system compliance include:

Objective	Target Date	Actual Date
Completion of the consolidation OPLOCs into the DFAS	Sep 98	Sep 98
Evaluations of all critical finance, accounting, and feeder systems	FY 01	TBD
Completion of the reduction of total finance and accounting systems from 334 systems to 38 or fewer systems	FY 03	TBD
Correction of system deficiencies	FY 03	TBD
Validation of systems compliance	FY 03	TBD
Achieve compliance for finance and accounting systems	FY 03	TBD
Achieve compliance for critical feeder systems	FY 03	TBD

Current Environment Composition

Summary During 1998, the DoD took a comprehensive look at its financial management operations and for the first time, articulated its concept for future operations. During 1999, the target architecture was expanded upon as an integrated financial management system for which the DoD established a baseline of critical finance, accounting, and feeder systems. In 2000, the DoD worked to implement a Financial and Feeder Systems Compliance Process in order to oversee and monitor actions underway or needed to ensure that its critical finance, accounting, and feeder systems meet federal financial management requirements.

Transition to the Integrated Financial Management System In moving forward, the DoD's financial management reform must accommodate three unavoidable constraints. First, the DoD cannot stop its financial operations while it fixes outdated business practices and flawed systems. Every day, the DoD must manage payrolls, pay contractors, and produce financial reports. These daily operating requirements impose a strong, practical constraint on the DoD's plans for improving systems and business practices.

Second, lasting reform demands consensus and collaboration. Few solutions rest exclusively within the jurisdiction of the financial management community. The development of an infrastructure capable of providing more accurate and reliable information and achieving auditable financial statements is a high priority.

Third, legislation in the 1990s has changed the accounting requirements within the U.S. Government. More recent legislation requires audited financial statements from federal agencies. This requires the DoD to track financial data on items from their purchase to disposal in a more integrated process. No longer can the DoD rely solely on separate systems monitoring separate categories.

The DoD has accepted these challenges, and each of the DoD's functional communities are actively engaged in implementing various aspects of the DoD's financial management reform initiatives.

The DoD envisions an aggressive future environment for its financial management that involves implementing integrated systems data entry and real-time data access. Since the DoD's business areas are widely diverse and complex and considering the overall size of the DoD and its activities, change of this magnitude poses a monumental challenge.

Ultimately, the DoD intends to achieve sound financial management through the efforts described in this plan. An integrated financial management system is the basis for efficient and effective operations from which sound financial management decisions are made. To move from the current environment to the

integrated financial management system, the DoD has a variety of strategies, as outlined in the following Transition Plan. As a result of these strategies and accompanying initiatives, the DoD expects to make substantial progress toward an integrated financial management system each year.
